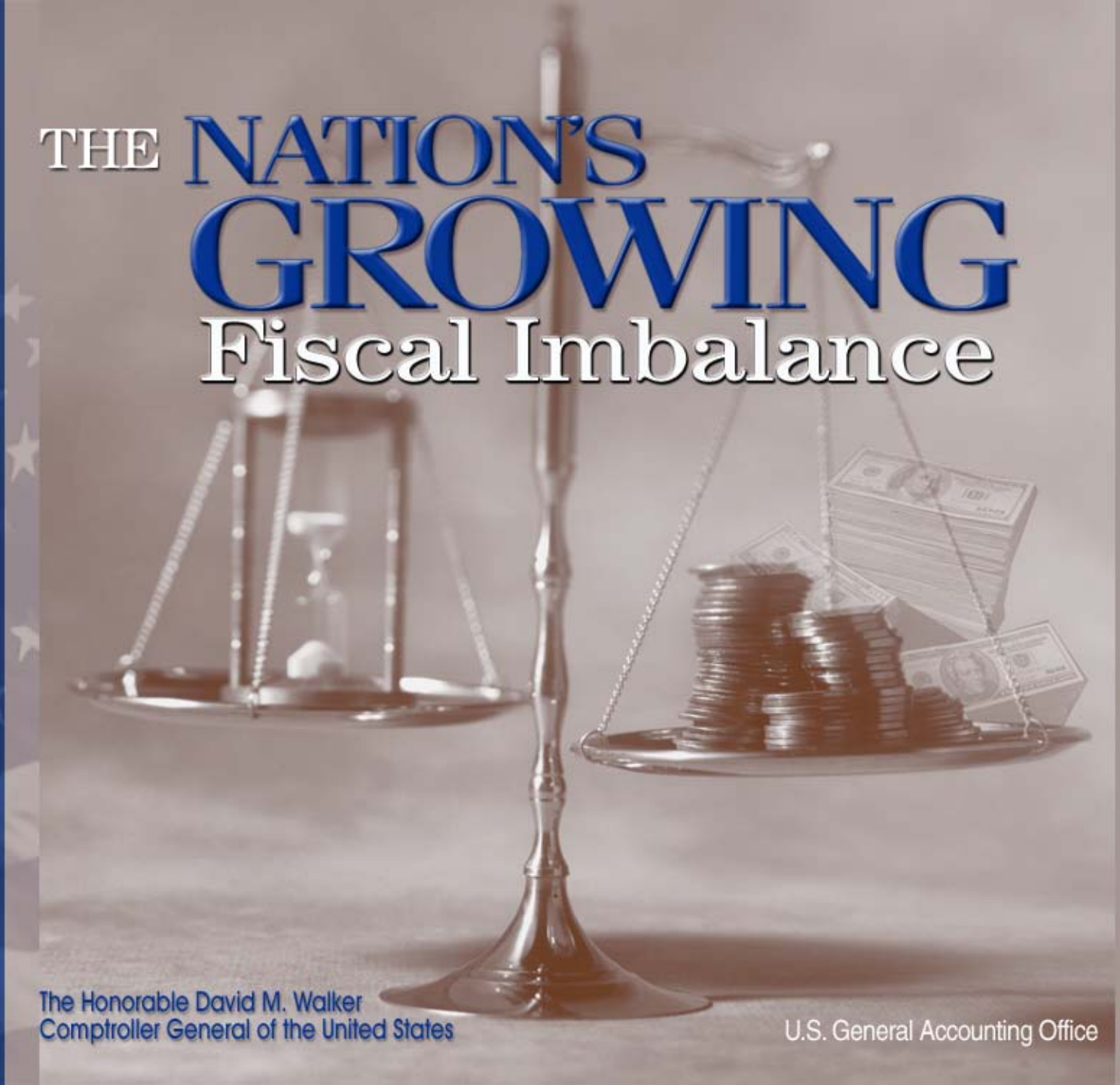
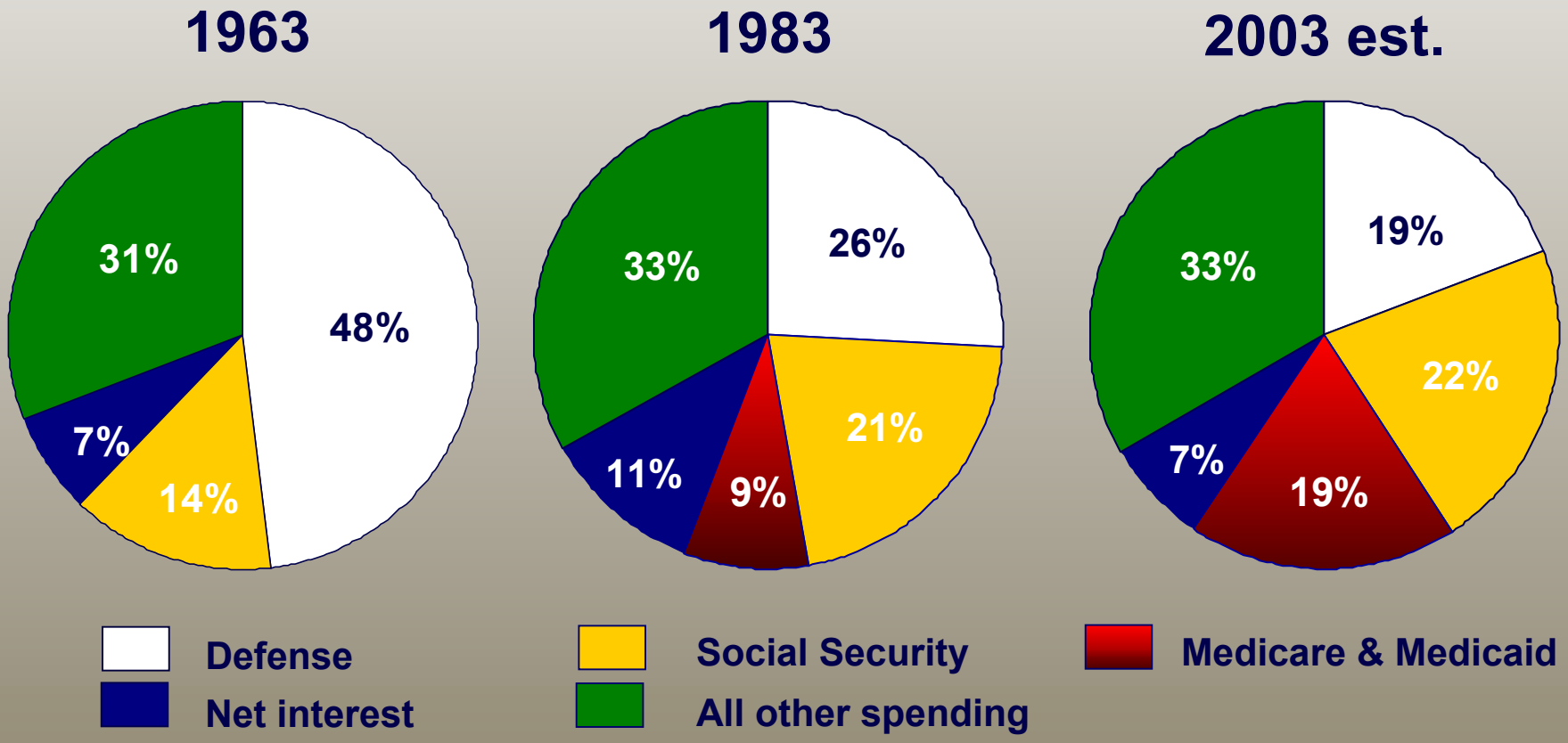


THE NATION'S GROWING Fiscal Imbalance

The Honorable David M. Walker
Comptroller General of the United States

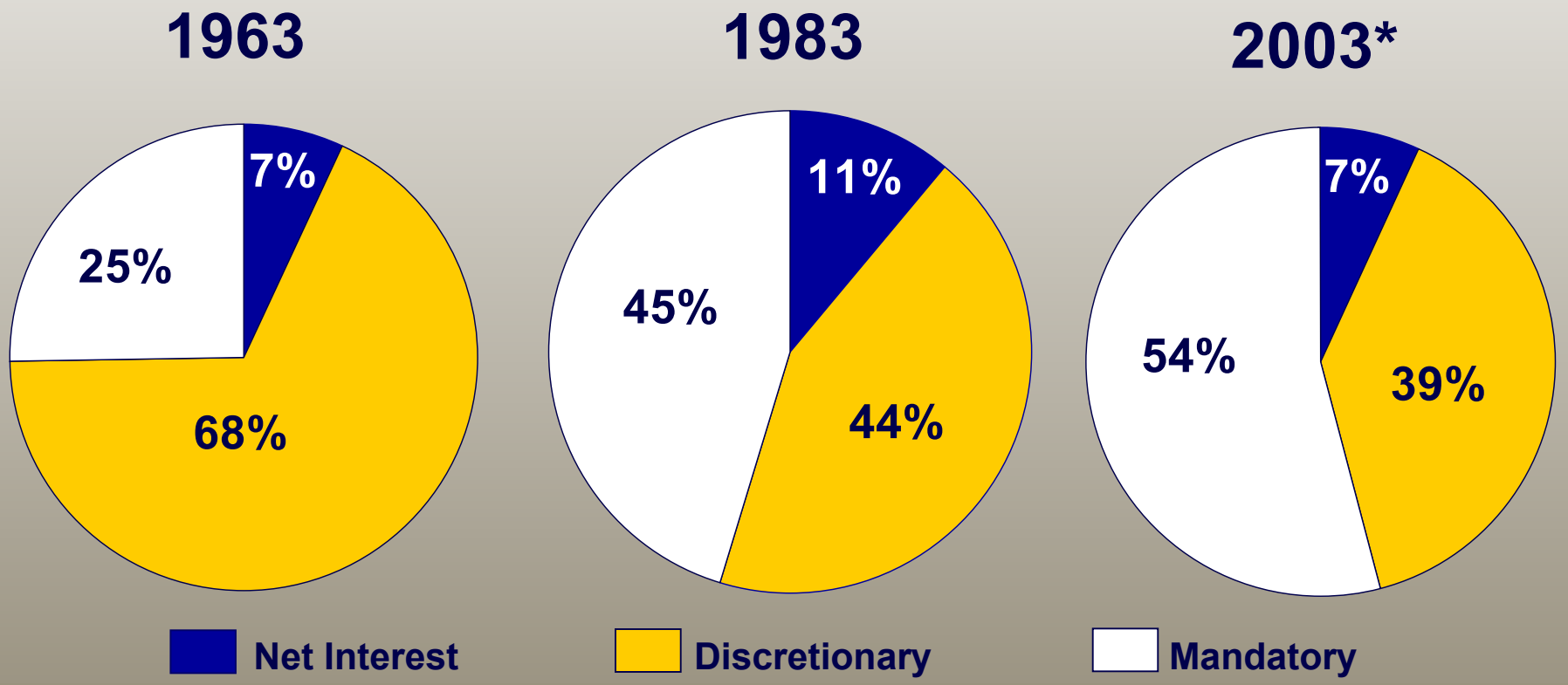
U.S. General Accounting Office

Composition of Federal Spending



Source: *Budget of the United States Government, FY 2004* , and *FY 2004 MidSession Review,* Office of Management and Budget.

Federal Spending for Mandatory and Discretionary Programs



* Estimate for 2003 includes $41 billion in discretionary spending and about $1 billion in mandatory spending for the Iraq war supplemental. Includes $11 billion in mandatory spending for the Jobs and Growth Tax Relief Reconciliation Act of 2003.

Source: *Budget of the United States: Fiscal Year 2004,* Office of Management and Budget, and GAO analysis of data from the Congressional Budget Office.

Selected Fiscal Exposures: Sources and Examples (End of FY 2002)

Type	Example (dollars in billions)
Explicit liabilities	Publicly held debt ($3,540) Military and civilian pension and post-retirement health ($2,673) Veterans benefits payable ($849) Environmental and disposal liabilities ($273) Loan guarantees ($28)
Explicit financial commitments	Undelivered orders ($539) Long-term leases ($50)
Explicit financial contingencies	Unadjudicated claims ($9) Pension Benefit Guaranty Corporation ($36) Other national insurance programs ($8) Government corporations e.g., Ginnie Mae
Implicit exposures implied by current policies or the public's expectations about the role of government	Debt held by government accounts ($2,674) Future Social Security benefit payments ($3,549)* Future Medicare Part A benefit payments ($5,931)* Future Medicare Part B benefit payments ($9,654)* Life cycle cost including deferred and future maintenance and operating costs (amount unknown) Government Sponsored Enterprises e.g., Fannie Mae and Freddie Mac

*Figures for Social Security and Medicare are as of January 1, 2003, and are estimated over a 75-year period. These amounts represent NPV and are net of debt held by the Trust Funds ($1,378 billion for Social Security, $235 billion for Medicare Part A, and $34 billion for Medicare Part B). The estimate for Social Security over an infinite horizon would be $10.5 trillion according to the Social Security Trustees' 2003 annual report. There is no infinite horizon estimate for Medicare included in the Medicare Trustees' 2003 annual report.

Note: These estimates will be updated following publication of the *FY 2003 U.S. Consolidated Financial Statement*.

Source: GAO analysis.

Another Way to Think About These Numbers

As of the End of FY 03

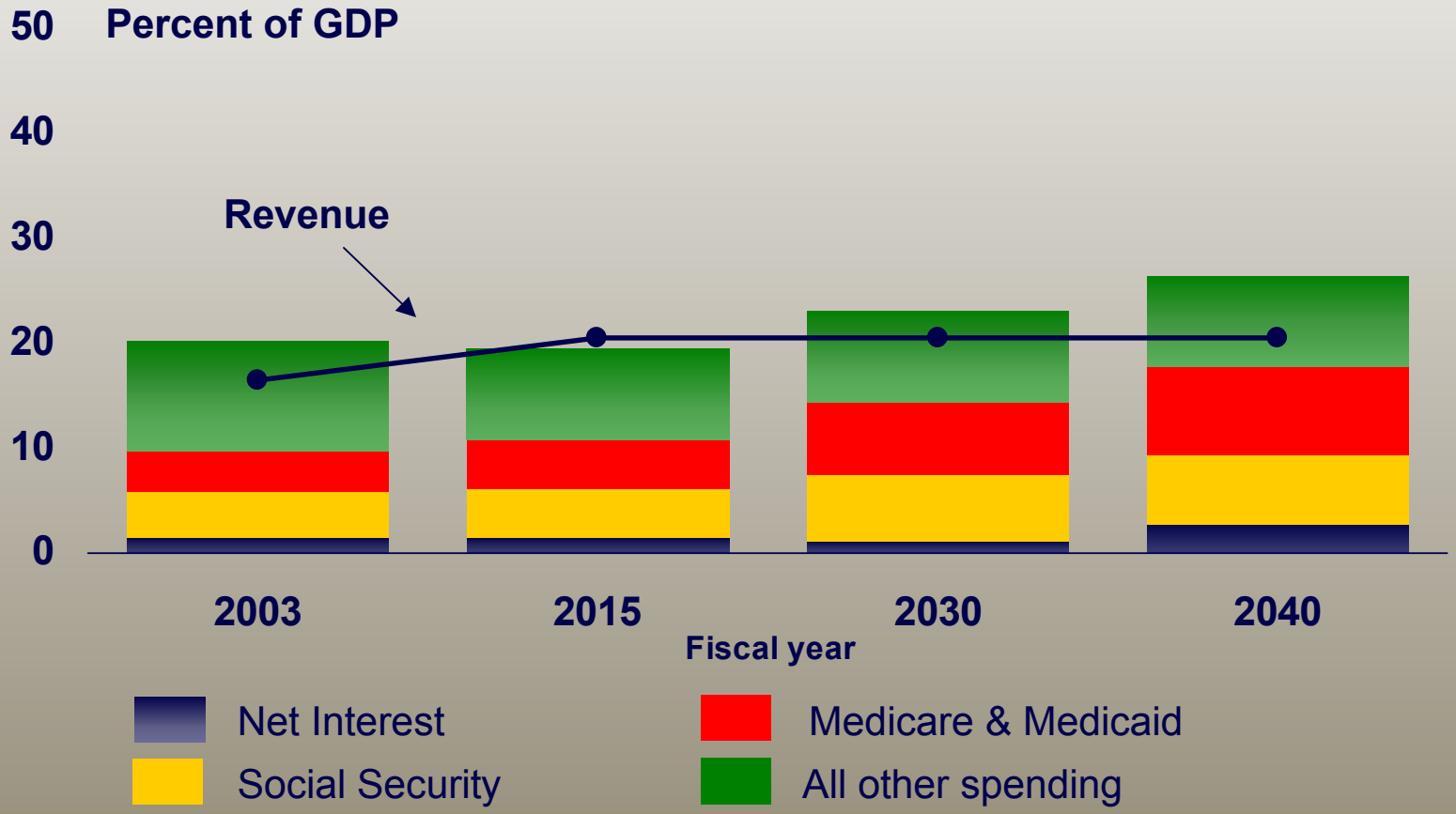
- Debt held by the Public—$3.9T
- Trust Fund Debt—$2.9T
- Gross Debt—$6.8T

- Gross Debt per Person—About $24,000

- If we add everything on the previous slide that is not included in gross debt, the burden per person rises to a little over $100,000. Alternatively, it amounts to a total unfunded burden of about $30 trillion in current dollars, which is roughly 15 times the current annual federal budget and 3 times the current annual GDP.

Note: The calculations only consider a 75-year horizon for Social Security and Medicare and excludes the new Medicare Part D benefit

Composition of Spending as a Share of GDP Under Baseline Extended

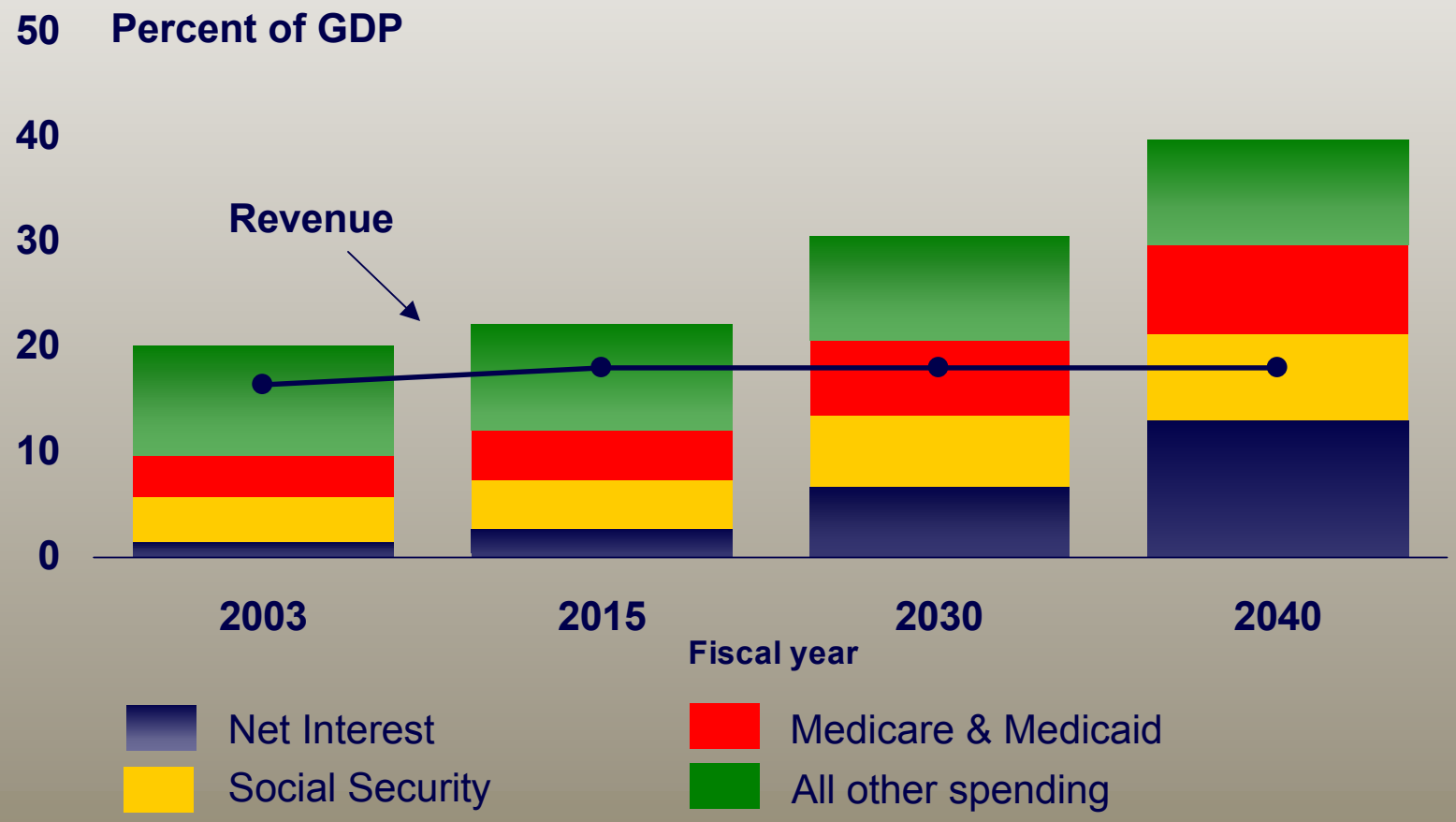


Notes: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2013 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2013, revenue as a share of GDP is held constant. This simulation assumes currently scheduled Social Security benefits are paid in full throughout the simulation period.

Source: GAO's August 2003 analysis.

Composition of Spending as a Share of GDP

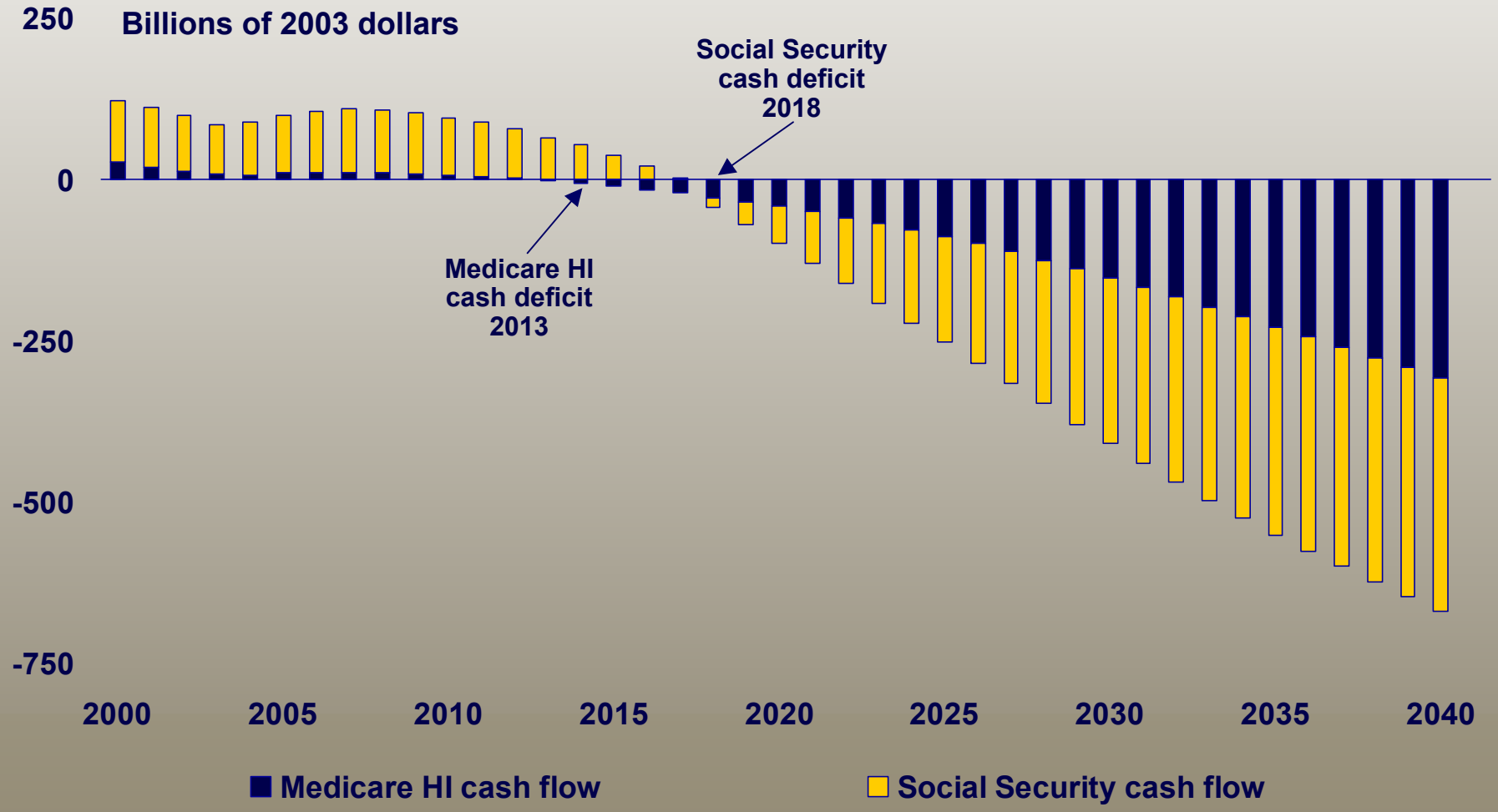
Assuming Discretionary Spending Grows with GDP after 2003 and All Expiring Tax Provisions Are Extended



Notes: Although all expiring tax cuts are extended, revenue as a share of GDP increases through 2013 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2013, revenue as a share of GDP is held constant. This simulation assumes that currently scheduled Social Security benefits are paid in full throughout the simulation period.

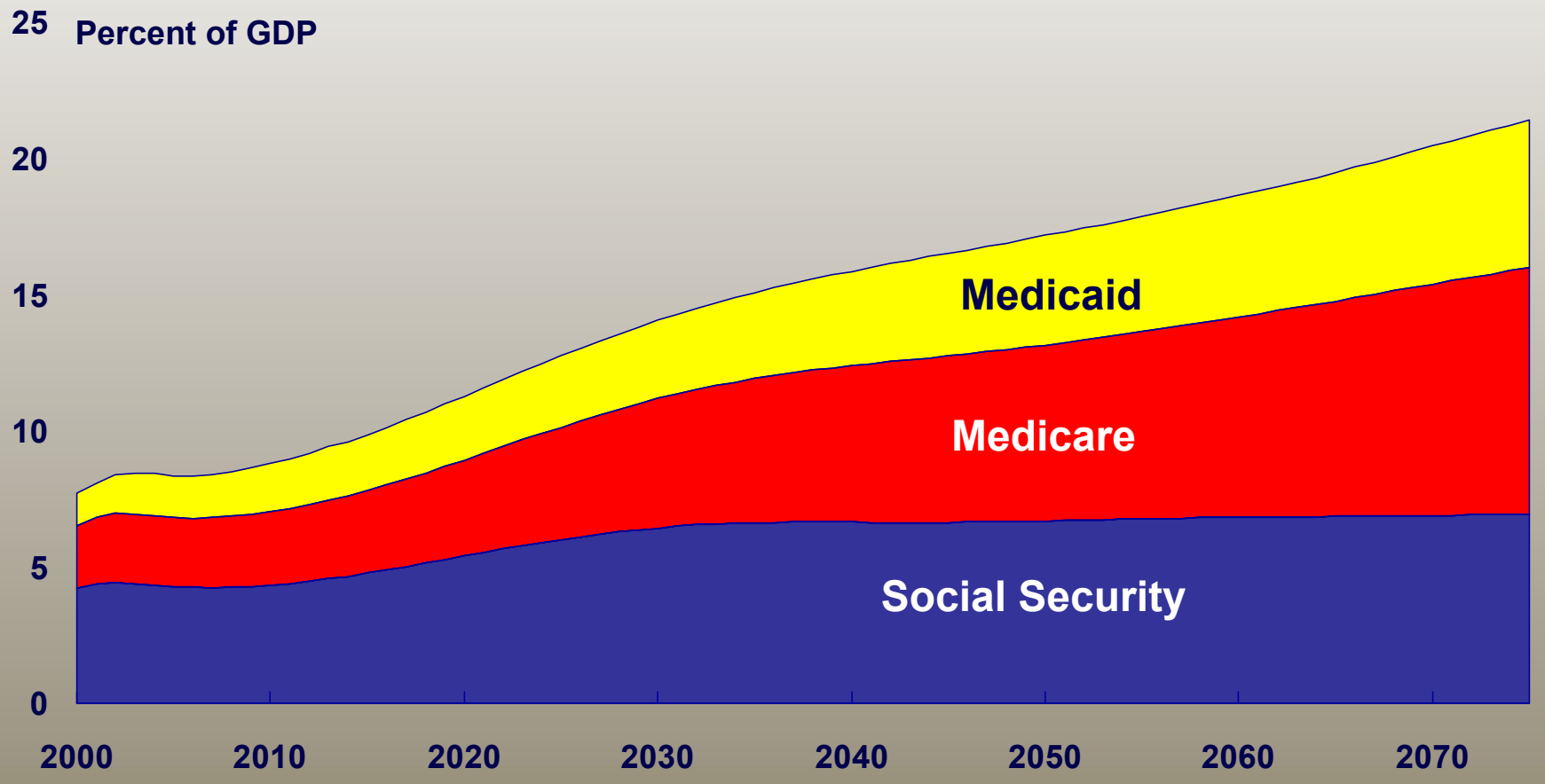
Source: GAO's August 2003 analysis.

Social Security and Medicare's Hospital Insurance Trust Funds Face Cash Deficits as Baby Boomers Begin to Retire



Source: GAO analysis based on the intermediate assumptions of *The 2003 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and the Federal Disability Insurance Trust Funds* and *The 2003 Annual Report of the Boards of Trustees of the Federal Hospital Insurance and Federal Supplementary Medical Insurance Trust Funds*. The above excludes Medicare Part B and the newly enacted Medicare Part D benefit.

Social Security, Medicare, and Medicaid Spending as a Percent of GDP



Source: Projections based on the intermediate assumptions of the 2003 Trustees' Reports, CBO's August 2003 short-term Medicaid estimates, and CBO's March 2003 long-term Medicaid projections. As a result, estimates do not include the recently enacted Medicare Part D.

Current Fiscal Policy Is Unsustainable

- **The "Status Quo" is Not an Option**
  - We face large and growing structural deficits largely due to known demographic trends and rising health care costs.
  - GAO's simulations show that balancing the budget in 2040 could require either
    - Cutting total federal spending in half or
    - Doubling federal taxes
  - The above does not include future costs for the new Medicare prescription drug benefit
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
  - Closing the current long-term fiscal gap based on responsible assumptions would require real average annual economic growth in the double digit range every year for the next 75 years.
  - During the 1990s, the economy grew at on average 3.2 percent per year.
  - As a result, we cannot simply grow our way out of this problem. Tough choices will be required.
- **The Sooner We Get Started, the Better**
  - Less change would be needed, and there would be more time to make adjustments.
  - The miracle of compounding would work with us rather than against us.
  - Our demographic changes will serve to make reform more difficult over time.

We Need a 3-Pronged Approach

- Restructure existing entitlement programs
- Reexamine the base of discretionary spending
- Review and revise our tax policy and enforcement programs

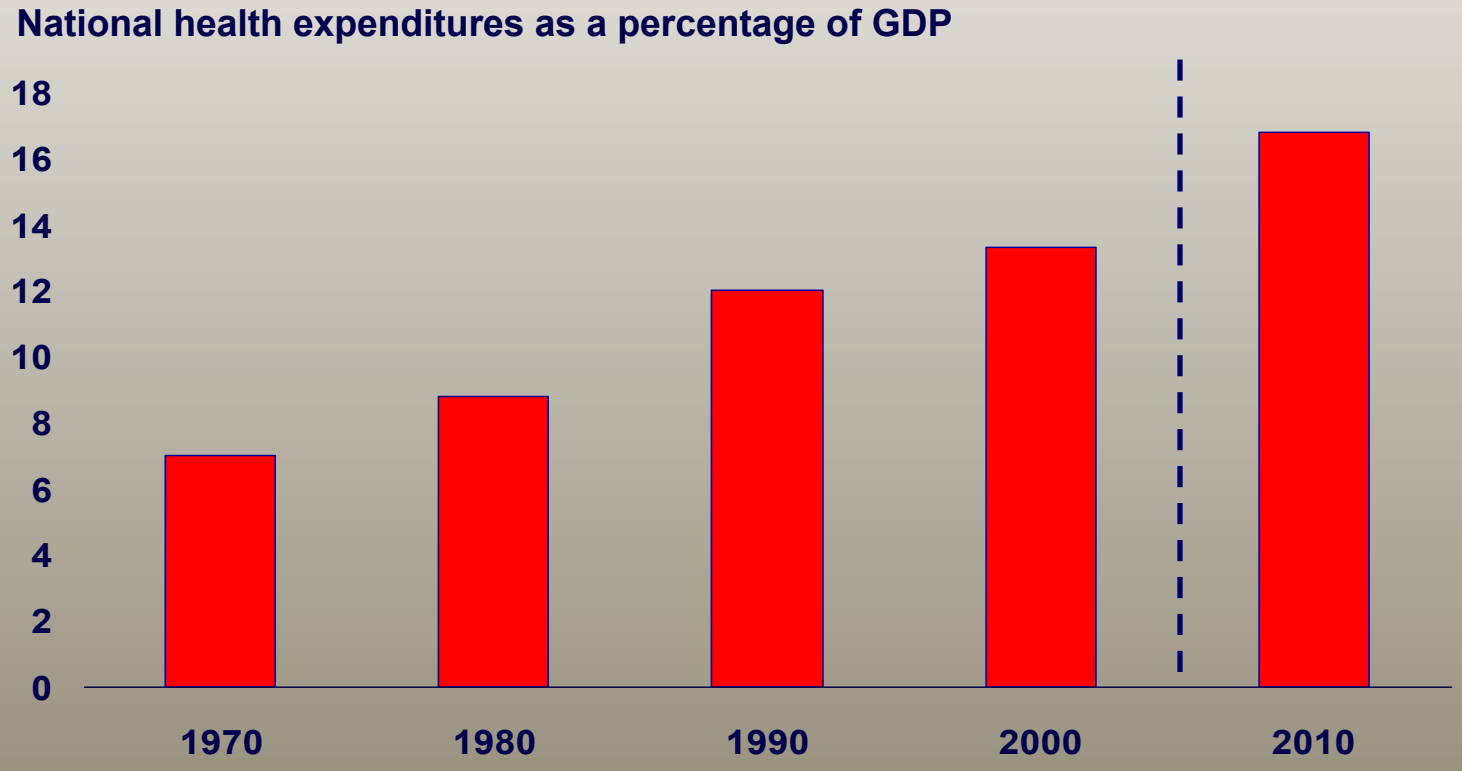
GAO Criteria for Evaluating Social Security Reform Proposals

Reform proposals should be evaluated as packages that strike a balance among individual reform elements and important interactive effects.

Comprehensive proposals can be evaluated against three basic criteria:

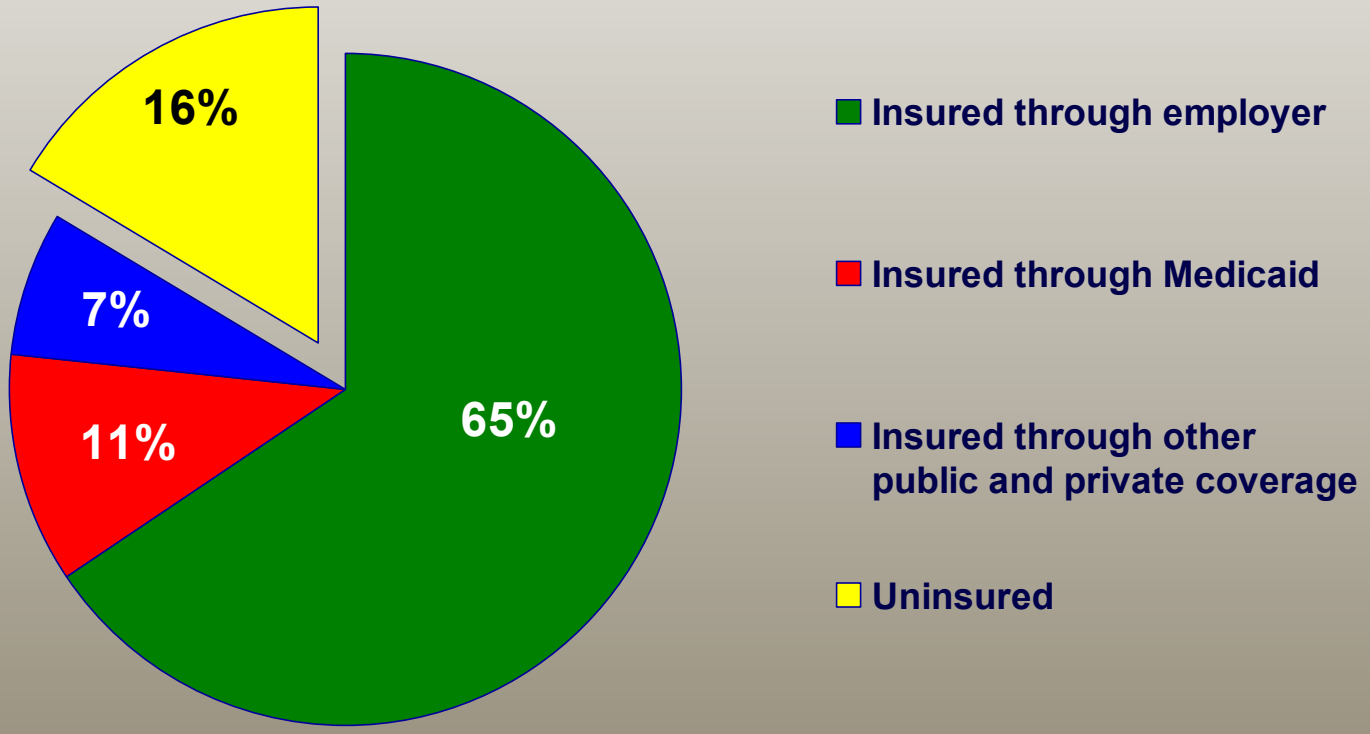
- Financing sustainable solvency
- Balancing adequacy and equity in the benefits structure
- Implementing and administering reforms

Health Expenditures Will Continue to Absorb an Increasing Share of GDP



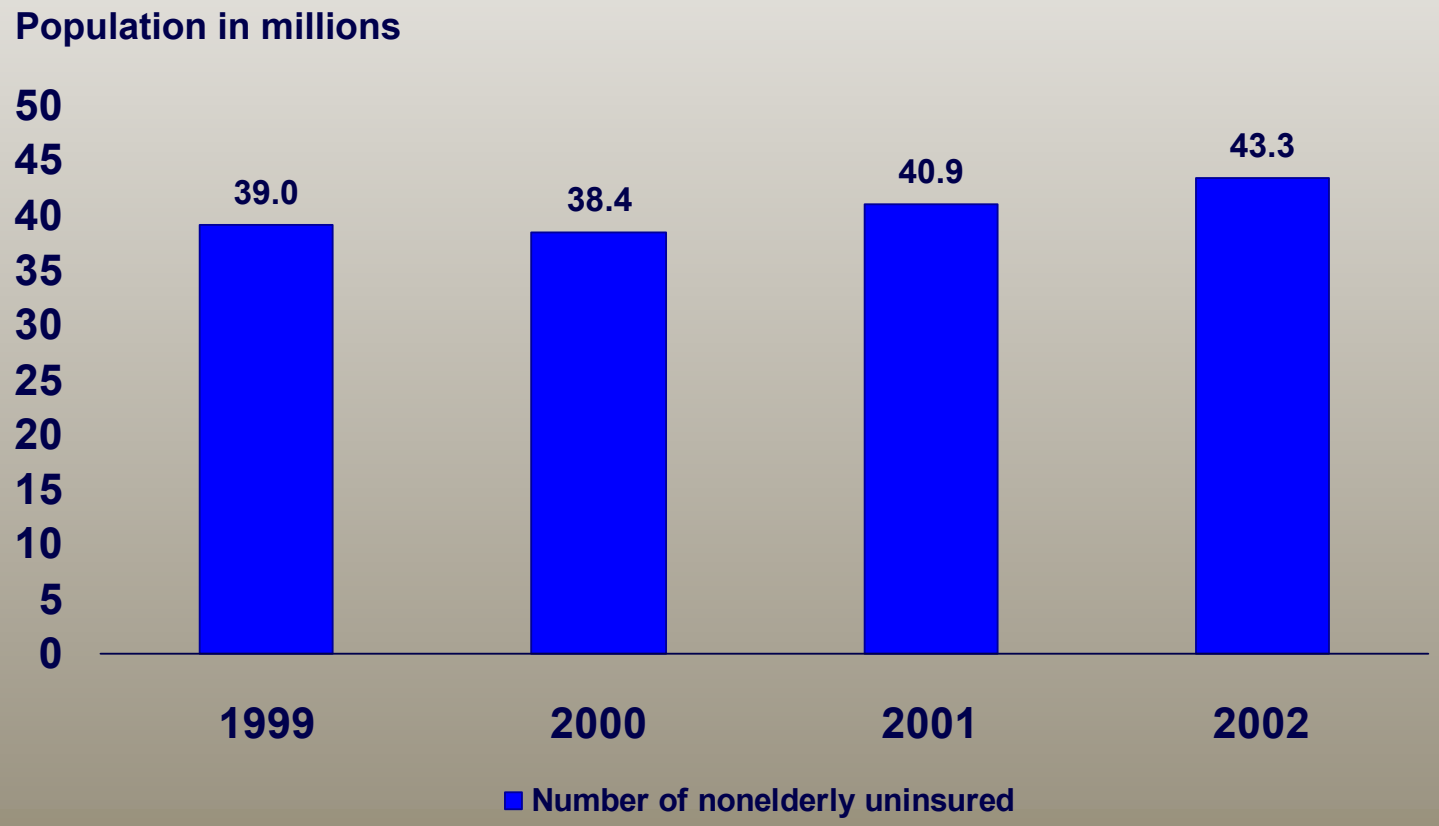
Source: CMS, OACT, National Health Statistics Group and U.S. Department of Commerce, Bureau of Economic Analysis.
Note: The figure for 2010 is projected.

In 2001, 16 Percent of the Nonelderly Population was Uninsured



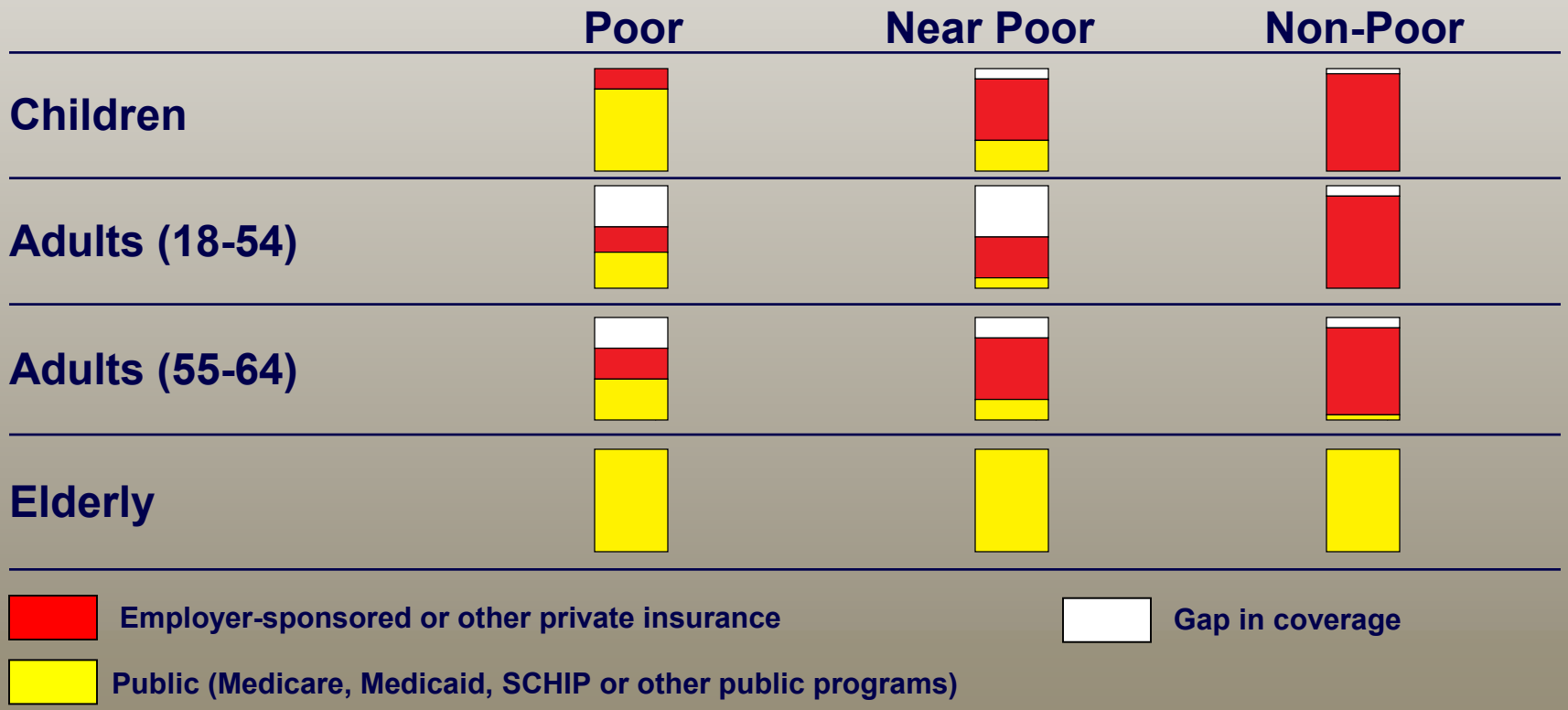
Source: GAO analysis of March 2002 Current Population Survey.
Note: Percentages may not add to 100 due to rounding.

In Recent Years, Roughly 40 million Americans Have Been Uninsured



Source: GAO, Urban Institute and Kaiser Commission on Medicaid and the Uninsured, analyses of the Bureau of the Labor Statistics and the Bureau of the Census Current Population Survey, Annual Demographic Supplements and Annual Social and Economic Supplement.
Note: Figures for 1999-2000 are from Urban Institute and Kaiser Commission on Medicaid and the Uninsured. The figures for 2001-2002 are from GAO analyses of the Current Population Survey.

Simplified View of Access to and Gaps in Health Care Coverage



Source: GAO analysis based on March 2002 Current Population Survey.

Simplified View of Coverage Gaps by Payer and Benefit Type

	Acute care services	Long-term care services	Prescription drug coverage[a]	Catastrophic coverage
Medicare	●	○	○	○
Medicaid[b]	●	●	●	●
Private insurance	●	○	▨	▨

● Covered by payer

○ Not covered by payer

▨ Coverage may be substantially limited

[a] Medicare will introduce a voluntary prescription drug benefit in 2006.

[b] While Medicaid coverage includes a broad range of services, access to these services may be limited. For example, some providers may be unwilling to accept Medicaid's fees, which are generally lower than those of other payers.

Need for Framework to Evaluate Health Care System Reforms

- Cost, access, and quality challenges—together with obstacles to achieving efficiency—argue for both comprehensive and fundamental health care system reform.
- Comprehensive reform may need to be accomplished on an installment basis in order to minimize disruptions and facilitate political consensus.
- A framework can guide an orderly process for setting common goals and assessing proposed reforms.

Health Care System Elements: Incentives, Transparency, and Accountability

- **Ideally, health care system reforms will**
  - align incentives for providers and consumers to make prudent choices about health insurance coverages and prudent decisions about the use of medical services,
  - foster transparency with respect to the value and costs of care, and
  - ensure accountability from health plans and providers to meet standards for appropriate use and quality.

The Way Forward

- Reexamine the base—question existing programs, policies and activities
- Implement new accounting and reporting approaches and new budget control mechanisms for considering the impact of spending and tax policies and decisions over the long term
- Develop new metrics for measuring the impact of policies and decisions over the long term (e.g., key national indicators to measure our Nation's position and progress over time and in relation to other countries)

Illustrative Re-examination Questions

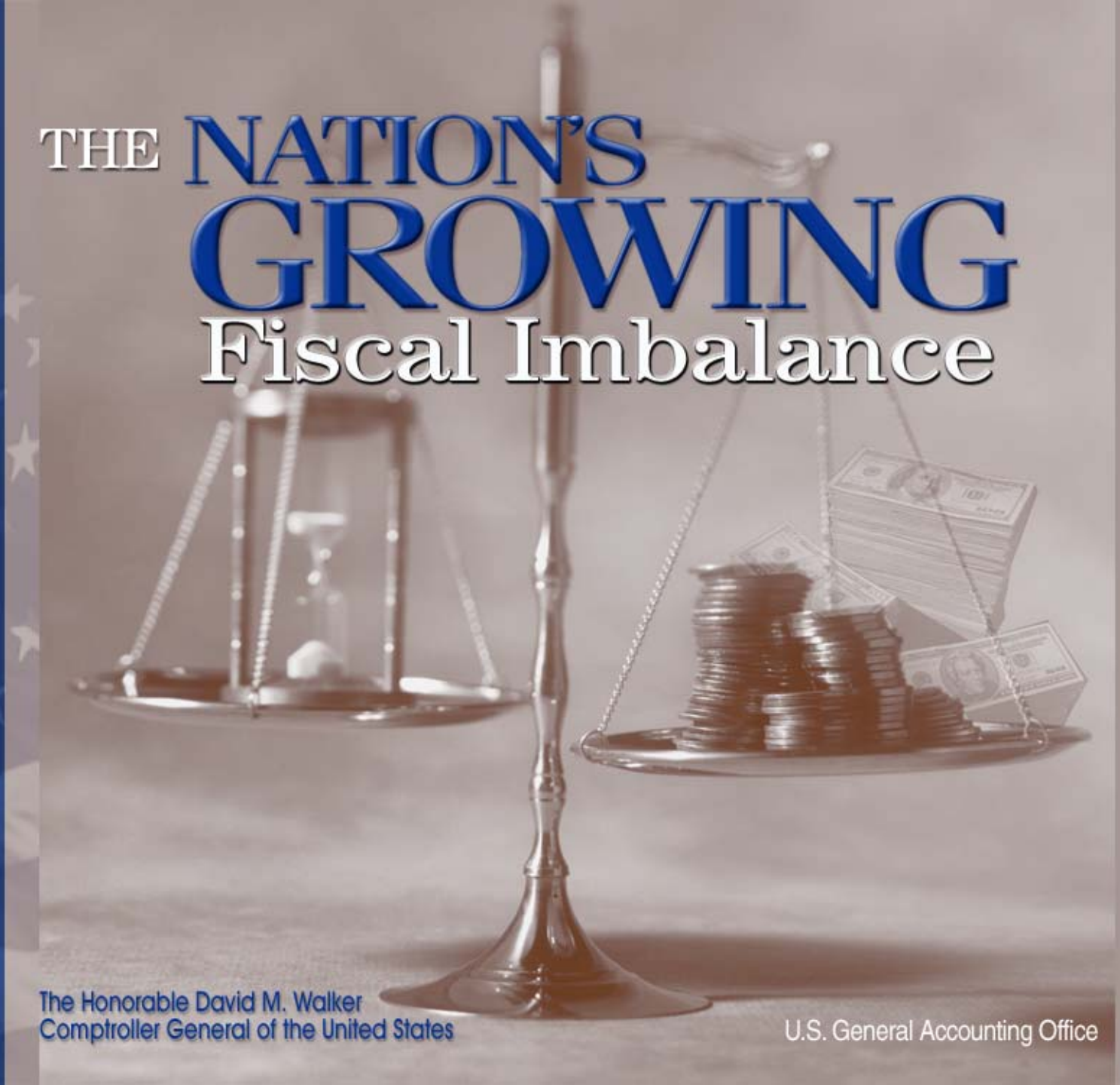
- Have there been significant social, economic and other changes that call into question the program's or policy's original rationale?
- Does it still address a critical problem not likely to be effectively addressed by the private sector or state and local governments?
- Is it achieving measurable and cost-effective results based on defined and desired outcomes?
- Is it well targeted?
- Is it designed and managed using best practices to achieve goals most efficiently and cost effectively?
- Would we create it in the same way if we were starting over today?
- What would happen if it was eliminated or cut by 25%?
- What are the opportunity costs and ripple effects of maintaining the status quo with regard to this program or policy?

Long-term Fiscal Challenges Demand New Metrics, Mechanisms, & Processes

- Accounting and reporting policies for trust funds, Social Security, Medicare, Veterans benefits, among other things, need to be reviewed and revised.
- The current budget time horizon [2-year, 5-year, 10-year] does not capture many long-term costs—e.g. Social Security, Medicare, pension insurance—and other major tax and spending provisions
- Cash and obligations-based budgeting is misleading for insurance and some benefit programs
- Budget controls have expired—and we need to go beyond "holding the line" to "changing the base" in spending and tax policies

Improved Metrics, Measures & Processes: Some Ideas

- Provide information on long-term costs of major spending and tax proposals before they are voted on, including showing long-term costs even for proposals that sunset
- Establish an OMB annual report on fiscal exposures, including appropriate measures and how to address them
- Consider fiscal targets, triggers, and points of order with focus on limiting growth of long-term commitments
- Move to accrual budgeting for employee pension, retiree health; disclose “risk assumed” [missing premium] for insurance
- Reinstitute budget controls (caps & PAYGO)



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